State of Wisconsin / OFFICE OF THE COMMISSIONER OF INSURANCE

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Written Testimony of Sean Dilweg
Commissioner of Insurance
Assembly Bill 403
Assembly Committee on Urban and Local Affairs
September 30, 2009

Chairperson Berceau, Vice-Chair Akkeren and Members, thank you for the opportunity to appear before you today. As Commissioner of Insurance I appreciate your time and will be brief with my testimony on AB403.

This bill directs the Local Government Property Insurance Fund (LGPIF), which OCI administers, to reduce premiums paid by insureds (Wisconsin local governments participating in the LGPIF) between October 1, 2009 and September 30, 2010. Insureds would receive a credit based on what they paid in premium in 2008, or what they would be billed for premium in 2010, whichever is less. We estimate this credit would be approximately $22.1 million, meaning for one year, the LGPIF we administer gets $22.1 million less in premium (little or no premium revenue) and participating local governments pay $22.1 million less in premium (little or no premium costs).

Unfortunately the cost to the LGPIF is actually much greater. Reducing premiums by $22.1 million requires that the LGPIF pay for reinsurance out of its balance, rather than out of annual premiums (since little, if any, would be collected), at a net cost of about $2 million (net of recoveries), and reduces LGPIF interest earnings by about $250,000. Thus the true impact on the LGPIF's balance from the premium holiday is a reduction of $24.3 million. And for local governments after the premium holiday year, the LGPIF will immediately need to start charging higher premiums to restore an adequate balance, as the cost of the bill is ultimately born by our insureds, i.e., participating local governments.

As Commissioner of Insurance I am the Manager of the LGPIF, and am responsible for its overall solvency and smooth functioning. The sole purpose of the LGPIF is to provide low cost property insurance for local governments. Over 1,100 local governments (counties, cities, villages, towns, school districts and special districts) insure their property with the LGPIF. As the Manager I must take a long-term perspective and manage the LGPIF to do what's best for the LGPIF and its insureds.

The LGPIF has operated for 100 years providing low cost property insurance only. It has no agents or commissions, no advertising nor profit, and a staff of just 1 FTE position. It is not a mandatory program. The LGPIF benefits participating local governments by charging rates generally lower than private market rates, and not rating local governments on their loss experience, since many losses are weather related.

To assist us in this task, we have a 21 member Advisory Committee of LGPIF insureds representing the various types of local governments in the LGPIF. Our Advisory Committee has told us they want rate stability. If the LGPIF carries a smaller surplus, insureds are more subject to major rate increases when we experience large losses. A larger surplus however, insulates the LGPIF and its insureds from having to make up for a large loss year in the very next year. This is part of what we try to achieve in managing the LGPIF. The balance of $41.1 million the LGPIF had on June 30, 2009 reflects the Advisory Committee's interests in keeping rates stable.

Further, LGPIF insureds already benefit from low rates, which have clearly been decreasing in recent years. Average premium rates we charge for building and contents have decreased (from $.60 to $.37 per $1,000 of coverage between 2004 and 2009) while total insurance in force has increased (from $35.9 billion in 2004 to $48.1 billion in 2009). LGPIF premium rates are quite a bargain compared to insurance in the private market. The rates are also lower than those charged by a comparable program run by North Dakota, which also requires a larger surplus than does Wisconsin.

As we went through the Legislative Audit Bureau audit process the surplus in the LGPIF was noted. However, the LGPIF is unique in that:

- The LGPIF is a monoline insurer (insuring property only) – losses cannot be shifted to other lines.
- The LGPIF must accept all eligible entries and cannot selectively underwrite, reject or terminate an insured based on its loss history.
- The only property insured is in Wisconsin, meaning the LGPIF is especially vulnerable to a large scale weather event like a tornado or hailstorms that could bring losses to many of our insureds – we have no ability to spread losses over a larger geographical area.
- Under s. 605.30, the ultimate backstop for the LGPIF beyond reinsurance we pay for is state GPR, a backstop we never want to use. A reasonable surplus reduces the likelihood we would need GPR to pay claims.

Creating a premium holiday seems attractive since local governments wouldn't have to pay premium for one year. However, the long-term attractiveness isn't as good.

It is important to note that under state law INS 6.72(1), -- no single risk of an insurer is to exceed 10% of surplus. Since the LGPIF retains the first $2 million per loss occurrence, and $2 million = 10% of $20 million, the LGPIF's minimum surplus must be at least $20 million.

To restore surplus just to the INS 6.72 (1) minimum level of $20 million, the projected rate increase in the year following the premium holiday is expected to be a 15% increase ($3.1 million) starting October 1, 2010 (using loss assumptions from the LGPIF's actuary) but could be as much as a 29% increase ($6.1 million) if the LGPIF experiences large losses similar to those that occurred in 2008. (Note by law the LGPIF must inform insureds of rate increases of 25% or more 60 days in advance of renewals, or August 1, 2010 for October 1, 2010 renewals.) To restore the larger surplus approved by the Advisory Committee in April 2009 would require even larger rate increases over several years.

Creating a premium holiday also creates some equity concerns, perverse incentives, and market questions.

- It is already stimulating some insureds that left the program to come back for at least a year to get the premium holiday.
- If we have to increase rates in October 2010 and beyond, there is an incentive for insureds to leave the program.
- It is inequitable if newer participants share proportionately in the premium holiday, since the surplus was built over many years from long-time participants.
- Insureds may change their deductible to maximize their premium holiday amount, which can further hurt the LGPIF by requiring it to cover a greater number of losses, and more severe losses. If all LGPIF insureds elect the minimum $500 deductible, our actuary projects the costs would increase by $4.5 million.
- A premium holiday may also cloud the perception of the LGPIF in the private marketplace, and possibly be used against the LGPIF. Our re-insurer may question whether we will have adequate funds to pay claims, and private companies may market against the LGPIF knowing that a large rate increase is coming. There is also a question as to whether there is a valid contract agreement in force since insurance is a promise to pay for a loss in consideration of premium paid.

In conclusion, these are difficult times for our local governments and the state should do what it can to help. However, it is questionable that local governments will benefit by not charging them anything today, knowing we will surely need to charge them more in the next few years to make up for the premium holiday. We prefer to keep gradually reducing the rates we charge and not jeopardize the long-term health of the LGPIF.

Having stable rates and a reasonable surplus is better for everyone than periodically experiencing deficits and rate increases.

A better approach than a premium holiday is a dividend. My recommendation is that the LGPIF declare a dividend to insureds of record as of September 1, 2009, based on each insured's relative percentage of earned premium over the most recent five fiscal years (FY2005-2009) compared to the overall total LGPIF earned premium for that same period; then multiplied by the amount of dividend declared; for example $5 or $10 million. The dividend amount could be issued by check or be deducted from the insured's renewal premium in the same manner as the premium holiday credit was to be administered. This method would produce a substantial boost for participating local governments, but with fewer fiscal, market and administrative consequences for the Fund and for those same local governments. We would be happy to work with the bill sponsors to craft such a solution.

Once again, thank you for the opportunity to testify on this matter.

Peter W.
BARCA
Majority Caucus Chairman

Co-Chair, Joint Committee on Audit
Committee on Financial Institutions
Committee on Jobs, the Economy & Small Business

September 30, 2009

Assembly Committee on Urban and Local Affairs

Assembly Bill 403

Representative Peter Barca

Chairwoman Berceau and members of the Assembly Committee Urban and Local Affairs, thank you for holding a public hearing on Assembly Bill 403, which would call for a one-year premium holiday for the school districts, municipalities, counties, and other public entities insured by the Local Government Property Insurance Fund.

The Local Government Property Insurance Fund is administered by the Office of the Commissioner of Insurance and provides property insurance to units of local government for publicly owned properties. The Fund covers over 1,100 units of local government including counties, school districts, cities, villages, towns, libraries, sanitary districts, fire departments, and water utilities.

A report released June 2009 by the nonpartisan Legislative Audit Bureau found that as of March 2009 the Local Government Property Insurance Fund had a surplus of $40 million. Despite record high claims in fiscal years 2005-06 through 2007-08, due in part to a significant number of weather-related claims, the Fund's surplus balance has increased by $12.2 million since June 30, 2004. The unusually large surplus in this fund is an indication that municipalities, counties, school districts, and other units of local government have been paying significantly beyond what is needed in premiums in recent years.

Due to the challenging economic times we currently face, school districts and units of local government have been squeezed by tight budgeting and reduced state support. This proposal would instruct the Office of the Commissioner of Insurance to reduce premiums due between October 1, 2009 and September 30, 2010 from each unit of local government insured by the Local Government Property Insurance Fund by an amount equal to the Fund premiums paid by that unit of government during calendar year 2008. Given that we are experiencing the worst economic recession since the Great Depression, if ever there was a time to provide relief to these local governments, now is the time.

In working on this legislation, I have reached out to Insurance Commissioner Sean Dilweg for his insights on this proposal. The commissioner has been able to provide valuable suggestions that I believe he will speak to today in terms of making this proposal work better for all involved. I look forward to continuing to work in collaboration with Commissioner Dilweg as we move forward with this initiative in order to provide relief to the affected public entities and the taxpayers who support them.

Thank you for your time today and I would appreciate your support when Assembly Bill 403 comes for a vote before this committee.

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September 30, 2009

Members of the Assembly Urban and Local Affairs Committee
State Capitol
Madison, WI

RE: Insurance Agents Oppose AB-403

Dear Chairperson Berceau and Members of the Assembly Urban and Local Affairs Committee:

The Professional Insurance Agents of Wisconsin and the Independent Insurance Agents of Wisconsin are asking you to not support AB-403 for passage. At first blush, it may appear to be a good idea to help some municipalities balance their budgets by providing for a premium holiday to the local government property insurance fund until 2010. Upon further reflection, however, the following key questions emerge:

- Is there really a surplus in the fund? The memos suggest that there is a surplus, but does one really exist from an actuarial viewpoint when looking at potential catastrophic liabilities?

- If there is really a surplus, is it a prudent decision to return the sum of approximately $22 million to participating municipalities through a premium holiday? Could one major catastrophic disaster to a municipality or other government entity put the entire fund in jeopardy? Is this proposal also threatening the long-term structural integrity of the fund?

- The legislation is basically a onetime shot in the arm for some local municipal budgets. Will this premium holiday really result in higher premiums being paid by the municipalities and a resulting need for tax increases to pay for the higher premiums in the following years to adequately protect the funds integrity in the future? Is it better to continue to pay the current premiums to avoid a rapid premium increase in the future?

- The premium holiday has a direct impact on private insurers. The state fund is in direct competition with property and casualty insurers in the state Wisconsin. The proposal virtually insures that all existing participants in the fund will stay with the fund through September of 2010, because they are being offered an "inducement" to do so. This means that no private carrier is going to be in a position to write any of that business on a competitive basis.

- Lastly, state law prohibits an insurance company or agent from offering an "unfair inducement" to someone for the purchase of insurance. Would a premium holiday be considered an "unfair inducement" or does the law not apply in this circumstance?

Our statewide membership of over 13,000 agents thanks you for your careful consideration of our concerns with regards to AB-403. If you have further questions, please feel free to contact either of us.

Sincerely,

Ron Von Haden
Executive Director
Professional Insurance Agents of Wisconsin

Bob Jartz
Executive Director
Independent Insurance Agents of Wisconsin

VILLAGE OF
WESTON

September 30, 2009

To whom it may concern:

The Village of Weston in Marathon County, WI supports Assembly Bill 403. During these tough economic times for municipalities this proposed Premium Holiday legislative initiative would bring a great deal of relief to the 2010 budget for the Village of Weston. Village staff forecasts the 2011 budget to be much better.

Thank you for your time and consideration.

Sincerely,

Sherry Weinkauf
Village Clerk

John Jacobs
Finance Director

Weston Municipal Center
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